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# State Controller's Financial Overview

## **ECONOMIC OUTLOOK**

The current economic outlook for California is the best it has been in more than six years. The State is producing jobs at a higher rate than the nation as a whole, and the unemployment rate continues to fall. By November 1995, the State had replaced the 500,000 jobs lost during the 1990–93 recession; by September 1996, employment in the State was almost 300,000 jobs above the 1990 peak. The lack of jobs that triggered the out-migration of workers and dampened the recovery of the housing industry appears to be turning around. This will be beneficial not only to the growth of employment in construction, but to other sectors as well. The California index of leading indicators has been climbing steeply since June of 1995, and the September 1996 reading indicates that economic growth in the State should remain strong throughout the next 12 months.

Population growth in California is typically higher than for the nation as a whole. As a consequence of the recession in the first three years of this decade, the rate of California's population growth has dropped to about 1% annually, paralleling that of the nation. In the next three years, the rate of population growth will probably rise to exceed the rate of the nation as a whole, with an average of about 1.2% annually.

Although the State's unemployment rate is high compared to that of the rest of the United States, it has been dropping rapidly over the past two years. In September 1996, it dropped to 7% — the lowest reading since January 1991. California's unemployment rates may remain higher than the national average over the next two years, but that will be partially due to current residents who choose to re-enter the labor force. However, as higher proportions of Californians enter the job force, per capita income and tax revenue growth will continue to be strong in California.

The distribution of California's non-farm employment by industry is similar to that of the United States as a whole. For both the State and the nation, the primary changes in the distribution of employment by industry over the past two decades have been the decline in manufacturing and the rise in service employment. Service employment, the largest sector of the economy, employs 27% of all California workers. In the past six years, construction employment in California has declined relative to the economy as a whole, but this is projected to be only a temporary change.

Significant employment reductions also have been seen in the fields of finance and real estate. These industries saw declines that are related both to cyclical factors, which are temporary in duration, and to restructuring, which will likely lead to a permanent reduction in employment in those industries.

Though California historically has been a high income State, the recent recession caused a sharp drop in the State's per capita income compared to the national average. But it should be noted that there also has been a longer trend change in California's national position. In 1960, per capita income in California was 23.5% above the national average. In 1990, before the recession had peaked, per capita income in California was only 11.2% above the national average. By 1994, per capita income had reached a low of only 3.3% above the national average. In 1995, however, personal income in California began to rise relative to the nation. As employment gains raise labor force participation rates in the next year, there will likely be a hearty resurgence of the growth of per capita income.

During the recession, state expenditures, primarily those for health and welfare, grew rapidly. At the same time, state revenues fell. In the past fiscal year, there has been a complete reversal of that pattern. Health and welfare caseloads have begun to subside, the Legislature has approved grant reductions in major welfare programs, and revenue growth has increased sharply. As a result, the State has been able to repay the last of the debt that was incurred to bridge the revenue gap created by the recession. California also has been able to significantly increase funding for education.

The outlook for revenues in the current fiscal year continues to be optimistic. Despite a reduction of the top personal income tax brackets and corporate tax rates, revenue growth continues to be strong in 1996. During the first four months of the 1996–97 fiscal year, the three major revenue sources for the State (bank and corporation taxes, personal income taxes, and retail sales taxes) have shown an increase of 10.2% from the same period in the 1995–96 fiscal year.

The gross state product of California is expected to total \$959 billion in 1996 and currently represents 12.6% of the nation's gross domestic product. The California economy is the seventh largest of any political entity in the world. The State is a world leader in the high technology industries of bio-technology, computers, multi-media, and communications. These factors put California in a good strategic position to maintain strong economic growth in the future.

## **MAJOR INITIATIVES FOR THE YEAR**

The 1996–97 Budget Act reflects an improvement in the near-term fiscal outlook for California. The Budget Act eliminates the accumulated budget deficit carried over from prior recessionary years and provides funding increases for K–14 education.

The 1996–97 Budget Act was signed by the Governor on July 15, 1996. Projected General Fund revenues and transfers of \$47.6 billion represent a 6.0% increase over the prior fiscal year.

General Fund expenditures of \$47.3 billion represent a 9.0% increase over the prior fiscal year's Budget Act expenditure projections. The principal features of the 1996–97 Budget Act were the following:

1. Larger-than-expected revenue gains in 1995–96 and 1996–97 resulted in major increases in the Proposition 98 minimum funding requirement. The 1996–97 budget includes the spending of Proposition 98 funds on class size reduction and a variety of related initiatives.
2. The 1996–97 Budget Act includes a 5% reduction in the bank and corporation tax rate, with an effective date of January 1997.
3. The 1996–97 Budget Act also includes a variety of reductions to non-education spending. This includes the extension of certain welfare grant reductions made in past years, and the suspension of the Renters' Tax Credit for an additional year. These savings are partly offset by new initiatives in local law enforcement, family planning, teen pregnancy prevention, and new funds for higher education.

The 1996–97 Budget Act reflects the continued economic expansion and state General Fund revenue growth outlook, and therefore contains no new tax increases.

Since the passage of the state budget, the federal government has passed, and the President has signed into law measures to enact federal welfare reform. These measures could result in either cost increases or decreases in state welfare programs during 1996–97, depending on how they are implemented in California. These potential effects are not likely to be major in the current year, but will have a variety of state-level fiscal impacts – especially in future years.

The passage of the 1997 federal budget could also have an effect on California's budget. Although funding was authorized in federal immigration reform legislation for Medi-Cal services to undocumented persons, the 1997 federal budget does not appropriate any of the additional federal funds assumed in the State's budget for this purpose.

## **FINANCIAL INFORMATION**

**Reporting Entity:** The financial reporting entity of the State includes all the funds and account groups of the primary government as well as all of its component units. Component units are legally separate entities for which the primary government is financially accountable. Blended component units, although legally separate entities, are, in substance, part of the primary government's operations and are included as part of the primary government. Accordingly, the building authorities are reported within the capital projects funds of the primary government. The lease agreements, amounting to \$320 million

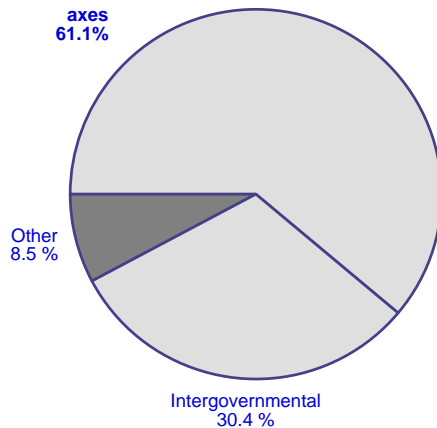
between the building authorities and the State, have been eliminated from the combined balance sheet. Instead, only the underlying fixed assets and the debt used to acquire them are reported in the appropriated account groups. Discretely presented component units are reported in separate columns in the combining financial statements to emphasize that they are legally separate from the primary government and to differentiate their financial position, results of operations, and cash flows from those of the primary government. The University of California and various Authorities are reported as discretely presented component units.

**Budgetary Controls:** Annually, the State Legislature prepares a budget that contains estimates of revenues and expenditures for the ensuing fiscal year. This budget is the result of negotiations between the Governor and State Legislature. Throughout the fiscal year, adjustments in the form of budget revisions, executive orders, and financial legislation agreed to by the parties are made to the budget. The Controller is statutorily responsible for maintaining control over revenues due the State and the expenditure of each appropriation contained in the budget. Budgeted appropriations are the expenditure authorizations that allow state agencies to purchase or create liabilities for goods and services.

The State's accounting system provides the Controller's Office with a centralized control record system to fully account for each budgeted appropriation, including its unexpended balance, and for all cash receipts and disbursements. The accounting system is decentralized in that the detail of each control account is maintained at the agency level. During the fiscal year, the control accounts and agency accounts are maintained and reconciled on a cash basis. At the end of the fiscal year, each agency prepares annual accrual reports for receivables and payables. The Controller's Office combines its control accounts with the agency accrual reports to prepare the *Budgetary/Legal Basis Annual Report* and *Budgetary/Legal Basis Annual Report Supplement*. The methods of accounting for expenditures and revenues in this report are governed by state laws and regulations that, in some cases, are not in full agreement with generally accepted accounting principles. The information in the State's *Comprehensive Annual Financial Report* presents a consolidation of the amounts in the *Budgetary/Legal Basis Annual Report* and adjustments to the account balances to conform to generally accepted accounting principles.

**Internal Controls:** The State has established an internal control structure designed to ensure that the assets of the government are protected from loss, theft, or misuse, and to ensure that adequate accounting data are compiled to allow for the preparation of financial statements in conformity with generally accepted accounting principles. The internal control structure is designed to provide reasonable, but not absolute, assurance that

**REVENUES 1995-96**  
General, Special Revenue, and  
Capital Projects Funds

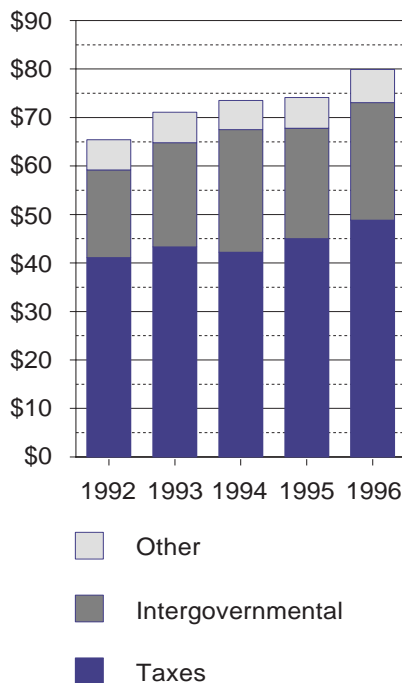


these objectives are met. The concept of reasonable assurance recognizes that: (1) the cost of a control should not exceed the benefits likely to be derived, and (2) the valuation of costs and benefits requires estimates and judgments by management. In addition, the government maintains extensive budgetary controls. The objective of these controls is to ensure compliance with legal provisions embodied in the annual appropriated budget approved by the Legislature.

**General Government Functions:** The government provides a full range of services including education, health and social services, transportation, law, justice, public safety, recreation, resource development, and public improvements. These general government functions are accounted for in the State's General Fund, special revenue funds, and capital projects funds.

**1995-96 Revenues:** Table 1 presents a summary of General Fund, special revenue funds, and capital projects funds revenues for the year ended June 30, 1996. Revenues for the State's General Fund, special revenue funds, and capital projects funds totaled \$79.9 billion for the fiscal year ended June 30, 1996. This was an increase of \$5.7 billion, or 7.6%, over the previous year. The major components of this change were tax and intergovernmental revenues. Tax revenues increased \$3.9 billion, or 8.6%, over the previous year. Intergovernmental revenue would have shown a decrease of \$1.1 billion except for the inclusion of \$2.5 billion of federal receipts related to food stamps, which are being reflected in the statements for the first time.

**REVENUE  
by SOURCE**  
General, Special Revenue, and  
Capital Projects Funds  
(Amounts in billions)



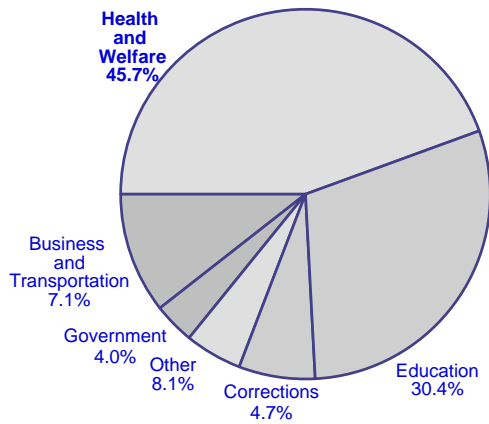
**Table 1**

**Schedule of General Fund, Special Revenue Funds, and Capital Projects Funds Revenues**

Year Ended June 30, 1996 (Amounts in thousands)

Revenues	1995-96 Amount	Percent of Total	Increase (Decrease) from 1994-95	Percent of Increase (Decrease)
Taxes.....	\$ 48,806,164	61.1 %	\$ 3,865,968	8.6 %
Intergovernmental.....	24,337,762	30.4	1,404,682	6.1
Other:				
Licenses and permits.....	2,938,539	3.7	106,023	3.7
Fees.....	1,499,821	1.9	130,761	9.6
Other minor.....	974,427	1.2	290,008	42.4
Interest.....	495,887	0.6	(42,772)	(7.9)
Penalties.....	402,445	0.5	(82,792)	(17.1)
Charges for services.....	388,700	0.5	(7,113)	(1.8)
Natural resources.....	73,038	0.1	3,150	4.5
<b>Total.....</b>	<b>\$ 79,916,783</b>	<b>100.0 %</b>	<b>\$ 5,667,915</b>	<b>7.6</b>

**EXPENDITURES 1995-96**  
General, Special Revenue and  
Capital Projects Funds

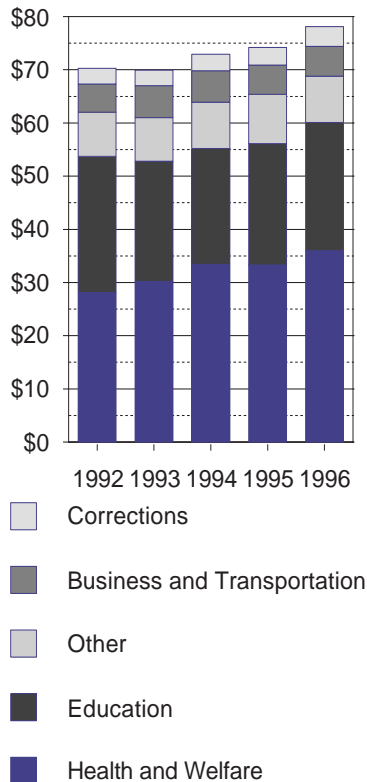


*Five-Year Trend:* Total revenues for the General Fund, special revenue funds, and capital project funds have increased from \$65.4 billion in 1992 to \$79.9 billion in 1996. This was an increase of \$14.5 billion, or 22.1%. This trend of increasing revenue is mainly attributable to an increase of intergovernmental transfers, which have grown from \$18.1 billion in 1992 to \$24.3 billion in 1996, which was an increase of \$6.2 billion, or 34.3%. Revenues for the five-year period increased \$7.2 billion, \$5.7 billion, \$2.4 billion, \$0.8 billion and \$5.7 billion in fiscal years 1991-92, 1992-93, 1993-94, 1994-95 and 1995-96, respectively.

**1995-96 Expenditures:** Table 2 presents a summary of General Fund, special revenue funds, and capital projects funds expenditures for the year ended June 30, 1996.

Expenditures for the State's General Fund, special revenue funds, and capital projects funds totaled \$78.8 billion for the fiscal year ended June 30, 1996. This was an increase of 6.2%, or \$4.6 billion, over 1995. Changes in expenditures by function from the last fiscal year levels are presented in Table 2. The major components of the 1995-96 change from the prior fiscal year is attributable to expenditures for health and welfare, education, and capital outlay. Health and welfare expenditures increased \$2.7 billion over the previous year, of which \$2.5 billion was caused by the inclusion of food stamp expenditures which are being reflected in the statements for the first time.

**EXPENDITURES by FUNCTION**  
General, Special Revenue, and  
Capital Projects Funds  
(Amounts in billions)



**Table 2**

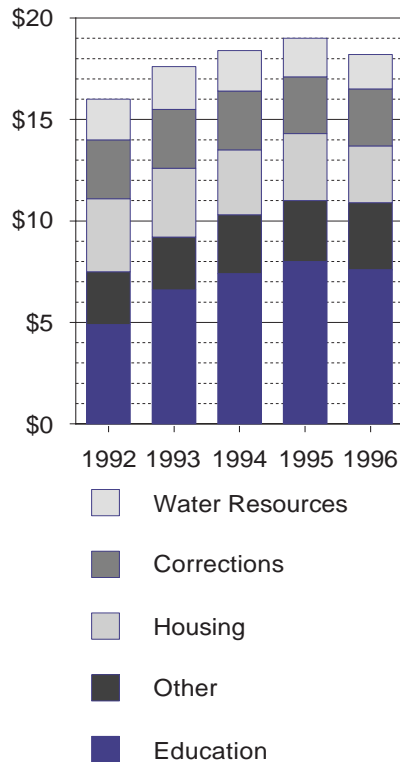
**Schedule of General Fund, Special Revenue Funds, and Capital Projects Funds Expenditures**

Year Ended June 30, 1996 (Amounts in thousands)

Function	1995-96 Amount	Percent of Total	Increase (Decrease) from 1994-95	Percent of Increase (Decrease)
Health and welfare.....	\$ 36,001,362	45.7 %	\$ 2,665,646	8.0 %
Education.....	23,978,493	30.4	1,209,137	5.3
Business and transportation.....	5,599,561	7.1	100,128	1.8
General government.....	3,186,959	4.0	(708,810)	(18.2)
Correctional programs.....	3,692,696	4.7	402,503	12.2
Other:				
Debt service.....	2,218,273	2.8	(38,880)	(1.7)
Resources.....	1,823,369	2.3	87,527	5.0
State and consumer services.....	675,912	0.9	(17,067)	(2.5)
Property tax relief.....	470,127	0.6	(5,483)	(1.2)
Capital outlay.....	1,160,361	1.5	895,770	338.6
<b>Total.....</b>	<b>\$ 78,807,113</b>	<b>100.0 %</b>	<b>\$ 4,590,471</b>	<b>6.2</b>



**GENERAL  
OBLIGATION BONDS  
by FUNCTION**  
(Amounts in billions)



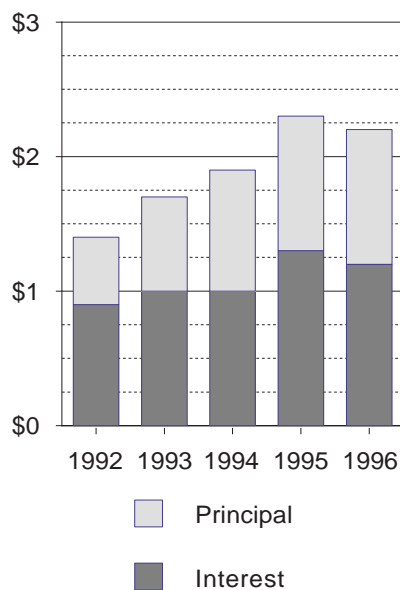
Education expenditures increased by \$1.2 billion, which was primarily related to an increase in the average daily attendance. In addition, this year's General Fund expenditures include the cost of the construction or acquisition of general fixed assets acquired through capital leases. Therefore, capital outlay increased by \$896 million, of which \$840 million was related to new capital leases used to acquire fixed assets.

**Five-Year Trend:** Total expenditures for the General Fund, special revenue funds, and capital projects funds have increased from \$70.3 billion in 1992 to \$78.8 billion in 1996. This is an increase of \$8.5 billion, or 12.1%. This trend of increasing expenditures is mainly attributable to the increase in health and welfare expenditures, from \$28.1 billion in 1992 to \$36.0 billion in 1996. This is an increase of \$7.9 billion, or 28.1%. In aggregate, expenditures for the five-year period increased (decreased) \$8.2 billion, \$(423) million, \$3.0 billion, \$1.4 billion, and \$4.6 billion in fiscal years 1991-92, 1992-93, 1993-94, 1994-95, and 1995-96, respectively.

**Debt Administration:** On July 30, 1996, Standard and Poor's Rating Group raised its bond rating for California from "A" to "A+," and in February 1996, Fitch Investors Services raised its rating from "A" to "A+." Moody's Investors Service rating is "A1."

**General Obligation Bonds:** General obligation bond debt, which is backed by the full faith and credit of the State, decreased from \$19.1 billion on June 30, 1995, to \$18.2 billion on June 30, 1996. This change reflected a decrease of \$871 million, or 4.6%.

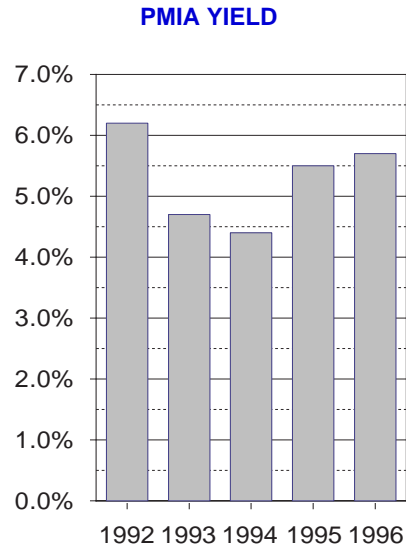
**DEBT SERVICE  
EXPENDITURES**  
(Amounts in billions)



**Five-Year Trend:** Total outstanding general obligation bonds have increased from \$15.9 billion in 1992 to \$18.2 billion in 1996. This is an increase of \$2.3 billion, or 14.5%. This trend of increasing bonded debt is mainly attributable to an increase in bonds for education purposes. The cumulative balance of these bonds has grown from \$4.9 billion in 1992 to \$7.6 billion in 1996, which reflects an increase of \$2.7 billion, or 55.1%. In aggregate, general obligation bonds for the five-year period increased (decreased) \$3.4 billion, \$1.7 billion, \$0.8 billion, \$0.7 billion, and \$(0.9) billion in fiscal years 1991-92, 1992-93, 1993-94, 1994-95, and 1995-96, respectively.

**Debt Service:** Principal retirement expenditures for the State's General Fund, special revenue funds, and capital projects funds totaled \$1.0 billion for the fiscal year ended June 30, 1996. This change reflected an increase of \$86 million, or 9.0%, over the previous year. Interest and fiscal charges for these funds totaled \$1.2 billion for the fiscal year ended June 30, 1996. This was a decrease of \$125 million, or 9.4%.

**Five-Year Trend:** General Fund, special revenue funds, and capital projects funds principal retirement expenditures



increased from \$523 million in 1992 to approximately \$1.0 billion in 1996, which was an increase of \$518 million or 99.0%. Interest and fiscal charges increased from \$910 million in 1992 to approximately \$1.2 billion in 1996, which was an increase of \$269 million, or 29.3%.

**Cash Management Policies and Practices:** Cash temporarily idle during the year was invested in the Pooled Money Investment Account (PMIA). The investment of the PMIA is restricted by law to the following categories: U.S. Government securities, securities of federally sponsored agencies, domestic corporate bonds, bank notes, interest-bearing time deposits in California banks and savings and loan associations, prime commercial paper, repurchase and reverse repurchase agreements, security loans, bankers' acceptances, negotiable certificates of deposit, and loans to various bond funds. The average daily investment balance for fiscal year 1995–96 amounted to \$26.6 billion, with an average effective yield of 5.8%. For the 1994–95 fiscal year, the average daily investment was \$26.8 billion and the average effective yield was 5.53%.

The *Pooled Money Investment Board's 40th Annual Report for Fiscal Year 1995–96* disclosed that the total earnings of the PMIA in the 1995–96 fiscal year amounted to \$1.5 billion. Of this amount, \$282 million was distributed to the General Fund, \$662 million to special funds, \$570 million to local governments, \$2 million to the Public Employees' Retirement System, and \$3 million to the State Teachers' Retirement System. The Pooled Money Investment Account Portfolio is shown in Table 3.

**Table 3**

**Pooled Money Investment Account Portfolio**

Year Ended June 30, 1996 (Amounts in thousands)

Function	Average Daily Portfolio	Percent of Portfolio	Annual Earnings	Average Effective Yield
Money market.....	\$ 12,740,224	47.9 %	\$ 731,133	5.7 %
Government securities.....	10,901,538	40.9	608,191	5.6
Corporate bonds.....	1,271,004	4.8	79,233	6.2
Loans to other funds.....	1,537,975	5.8	88,001	5.7
Repurchase agreements.....	183,166	0.7	10,289	5.6
Time deposits.....	351,060	1.3	19,416	5.5
Reverse repurchase agreements.....	(361,771)	(1.4)	10,289	(2.8)
<b>Total.....</b>	<b>\$ 26,623,196</b>	<b>100.0 %</b>	<b>\$ 1,546,552</b>	<b>5.8</b>

**General Fund Balance:** The State's General Fund ended fiscal year 1995–96 with a budgetary fund balance of \$1.1 billion and a



negative fund balance of \$769 million using generally accepted accounting principles. The budgetary fund balance is made up of \$2.2 billion in reserves and a deficit of \$1.1 billion in the unreserved-undesignated portion of the fund balance. The reserves represent that portion of the fund balance that is not available for appropriation or that is legally set aside for specific uses. The unreserved-undesignated portion represents the amount available without restrictions to fund the subsequent year's budget. Because there was a deficit, no carry-over funds from the fiscal year 1995–96 are available to finance the fiscal year 1996–97 budgetary plan. In addition, the General Fund needs to increase \$1.1 billion before funds become available for use as previously designated.

The Special Fund for Economic Uncertainties (the “rainy day fund”) was fully depleted, leaving a zero balance at the end of the fiscal year. Annually, an amount is appropriated in the General Fund to replenish the fund. This fund, as the name implies, provides the monies for those necessary expenditures throughout the year that have not been anticipated or provided for in the annual budget. It also provides relief, to the amount of its available funds, for any budgeted revenue shortfalls. The Controller of the State of California is required to transfer to this fund the lesser of the following amounts: (1) the difference between the State’s “appropriations subject to limitation” for the fiscal year that ended, and its “appropriation limit” as defined in the Budget Act for that fiscal year, and (2) the unencumbered balance in the General Fund.

**Proprietary Operations:** Proprietary fund types present financial data on state activities that are similar to those found in the private sector. Users are charged for the goods or services provided.

Enterprise funds account for goods or services provided to the general public on a continuing basis when the cost involved is to be financed or recovered primarily by user charges. Enterprise funds earned approximately \$3.9 billion in operating revenues and had \$2.8 billion in operating expenses for the year ended June 30, 1996.

Internal service funds account for state activities that provide goods and services to other state departments or agencies on a cost reimbursement basis. Internal service funds earned approximately \$1.1 billion in operating revenues and had \$1.2 billion in operating expenses for the year ended June 30, 1996.

**Fiduciary Operations:** Fiduciary fund types are used to account for assets held by the State as a trustee or agent. The State reports three fiduciary fund types: expendable trust funds, which account for assets held in a trustee capacity when both principal and income (earnings on principal) may be expended in the course of a fund’s designated operations; pension trust funds,

which account for transactions, assets, liabilities, and net assets available for plan benefits of the retirement systems; and agency funds, which account for assets held by the State and where the State acts as an agent for individuals, private organizations, other governments, or other funds. Expendable trust funds earned approximately \$7.7 billion in revenues and had \$6.8 billion in expenditures for the fiscal year ended June 30, 1996. Pension funds had \$26.9 billion in additions and \$7.0 billion in deductions to the net assets available for plan benefits. Agency funds had assets and liabilities of \$29.1 billion as of June 30, 1996.

**Risk Management:** The State has elected, with a few exceptions, to be self-insured against loss or liability. The State generally does not maintain reserves. Losses are covered by appropriations in the year in which the payment occurs. Workers' compensation benefits for self-insured agencies are initially paid by the State Compensation Insurance Fund. The State Compensation Insurance Fund estimated the liability for future workers' compensation claims against the State's self-insured agencies to be approximately \$733 million as of June 30, 1996. The liability of \$89 million is being reported in the General Fund, \$58 million in special revenue funds, \$20 million in proprietary funds, and \$566 million in the general long-term obligation account group.

**Independent Audit:** State statutes require an annual audit of the general purpose financial statements of the State. To meet this requirement, the State Auditor has examined the accompanying financial statements in accordance with government auditing standards issued by the Comptroller General of the United States and generally accepted auditing standards. The auditor's report on the general purpose financial statements and combining and individual fund statements and schedules is included in this report.

The State of California is required to undergo an annual single audit in conformity with the provisions of the Single Audit Act of 1984 and the U.S. Office of Management and Budget's Circular A-128, Audits of State and Local Governments. Generally accepted auditing standards and the standards set forth in the General Accounting Office's Governmental Auditing Standards were used by the auditors in conducting the engagement. Information related to this single audit, including a schedule of federal financial assistance, the independent auditor's report on internal controls and compliance with applicable laws and regulations, and a schedule of findings and questioned costs are included in a separately issued single audit report.

**Acknowledgements:** The preparation of this report could not have been accomplished without the efficient and dedicated services of state agency accounting departments and the staff of the State Controller's Division of Accounting and Reporting. We would like to express our appreciation to all those who contributed to the preparation of this report.

# Principal Officials of the State of California

## **Executive Branch**

Pete Wilson  
Governor

Gray Davis  
Lieutenant Governor

Kathleen Connell  
State Controller

Dan Lungren  
Attorney General

Matt Fong  
State Treasurer

Bill Jones  
Secretary of State

Delaine Eastin  
Superintendent of Public Instruction

Chuck Quackenbush  
Insurance Commissioner

### *Board of Equalization*

Johan Klehs, Member, First District  
Dean F. Andal, Member, Second District  
Ernest J. Dronenburg Jr., Member, Third District  
Brad Sherman, Member, Fourth District

## **Legislative Branch**

Bill Lockyer  
President pro Tempore, Senate

Cruz Bustamante  
Speaker of the Assembly

## **Judicial Branch**

Malcolm M. Lucas  
Chief Justice, State Supreme Court

# Organization Chart of the State of California

